S&P Global Ratings

RatingsDirect®

Summary:

State of Washington; Appropriations; General Obligation

Primary Credit Analyst:
Jillian Legnos, Hartford + 1 (617) 530 8243; jillian.legnos@spglobal.com

Secondary Contact:
Oscar Padilla, Dallas + 1 (214) 871 1405; oscar.padilla@spglobal.com

Table Of Contents

Summary:

State of Washington; Appropriations; General Obligation

Credit Profile		
US$132.77 mil MVFT GO rfdg bnds ser R-2022B due 02/01/2042		
Long Term Rating	AA+/Stable	New
US$131.845 mil various purp GO rfdg bnds ser R-2022A due 02/01/2037		
Long Term Rating	AA+/Stable	New
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the State of Washington's:

- $131.845 million series R-2022A various purpose general obligation (GO) refunding bonds; and
- $132.770 million series R-2022B motor vehicle fuel tax GO refunding bonds.

At the same time, S&P Global Ratings affirmed its 'AA+' long-term and underlying ratings on Washington's GO and motor vehicle fuel tax debt outstanding, and its 'AA' rating on the state's appropriation-backed debt outstanding. We rate the state's appropriation-backed debt obligations one notch lower than our rating on Washington to reflect the service contract and lease payments appropriated by the state legislature for the bonds. The outlook on all ratings is stable.

Our rating on the state's GO bonds reflects Washington's full faith, credit, and taxing powers. The motor vehicle fuel tax GO bonds are also secured and expected to be paid by motor vehicle fuel taxes.

Credit overview

Washington's credit profile is characterized by strong fiscal management practices, including strong forecasting and a history of making budget adjustments based on material change to forecasts. While we anticipate the state's debt profile will remain relatively high, we believe it is manageable given the state's comparatively low pension and other postemployment benefit liabilities.

In the near term, we believe the state's credit profile is stabilized by projections for strong economic growth. The state's most recent economic and revenue forecast, as of September 2021, slightly increased Washington's general fund revenues for the current fiscal 2021-2023 biennium compared with the state's previous forecast from June 2021. Specifically, we understand the $842.6 million, or 1.5%, increase for the biennium stems in part from an increase in state personal income as it relates to taxable economic activity; the state does not impose a personal income tax. For more information on Washington's latest revenue forecast, see below.

Washington's budget stabilization account (BSA) began the fiscal year essentially empty following a withdrawal in fiscal 2021 made to help manage the state's budget. However, the state maintained a strong ending near general fund balance of $3.8 billion, which we view as a strong 14.3% of annual near general fund expenditures that offsets the lowered BSA balance. Historically, the state's lack of a formal policy for its budget reserve level has allowed low balances to persist through protracted periods of economic and revenue softness.

During expansionary phases of the economic cycle, however, Washington consistently returns operating surpluses and good budgetary reserve positions. In line with this history, the state anticipates it will rebuild its BSA to $563 million by the end of the current fiscal 2021-2023 biennium. We consider this to be a low 1.8% of near general fund biennial expenditures in fiscal 2023 but note the anticipated ending near general fund balance is expected to remain strong at 12.8% for the same period. We view the state's commitment to rebuilding the reserve account as a positive credit factor.

In our view, Washington has a very strong liquidity profile. The average daily balance of the state treasury and treasurer's trust funds was a very strong $12.6 billion in September 2021, which represents21.3% of budgeted fiscal 2021-2023 biennial general fund and near general fund expenditures.

The ratings reflect our view of Washington's:

- Sales tax-based revenue structure, which has demonstrated less sensitivity to economic cycles than income tax-reliant states;
- Strong financial policies and practices, including statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced, which is key, given increasing expenditure pressures;
- High cost of housing, especially in key economic centers that could impede long-term growth prospects; and
- Moderately high debt burden across several measures, but relatively low unfunded pension and OPEB liability.

The stable outlook reflects our view that the state's strong budgetary management and forecasting practices help insulate the Washington rating from its budgetary pressures. The state's legal requirements to enact budgets that are balanced--not only for the current biennium, but subsequent biennia--help provide a sustainable framework to facilitate structural balance throughout economic cycles. While we expect that significant upward pressure on spending originating in legal- and voter-approved mandates over time will remain a soft point in the state's credit profile, we believe Washington's ability to enact budgets that are balanced--not only for the current biennium, but also project balance through the following biennium--helps facilitate a structural approach.

Based on the analytic factors we evaluate for states, we assigned a composite score for Washington of '1.7' on a four-point scale, whereby '1.0' is the strongest and '4.0' is the weakest.

For more information on our GO rating on the state, see our full analysis on the State of Washington, published Jan. 28, 2021, on RatingsDirect.

Environmental, social, and governance (ESG) factors

In our opinion, Washington's environmental risks are elevated, given a combination of exposure to rising sea levels along the state's vast coastline and risk of wildfires in its expansive forests. Washington, which has more than 3,000 miles of coastline, derives much of its economic activity from the Puget Sound region, which includes Seattle, Olympia, Tacoma, and Bremerton. Specifically, IHS Markit estimates half of the state's population and jobs are based in the area. Other areas of the state have experienced drought conditions for at least part of the year over the past decade, and officials expect dry conditions in summer months will likely persist in the decades ahead, contributing to wildfire risk. Washington reports it has begun preparing for a changing climate by integrating consideration of such changes into decision-making; multiple state agencies have been tasked with studying the impacts of climate change on their areas of focus and the Economic and Revenue Forecast Council prepares a climate study on an annual basis. In addition, the state's legislature has passed several bills in recent years addressing climate change including approving programs to reduce energy emissions.

We view Washington's social and governance risks as in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could lower our rating on Washington if, in the face of budgetary pressure, lawmakers delay taking corrective action in addressing revenue shortfalls or rely extensively on one-time solutions to remediate budget gaps. In our view, budgetary pressure could arise from the newly enacted capital gains tax's legal challenges or inherent cyclicality, job losses in the state's aviation industry, or diminished flexibility stemming from maintenance of various voter-approved spending initiatives or court actions (such as increases to education funding following the resolution of the McCleary decision), among others. State policymakers' response--whether timely or structurally oriented--will likely dictate any effect on our rating on Washington. We could also lower the rating if Washington fails to replenish its budget stabilization account in a timely manner, or we feel the state lacks a realistic plan to rebuild its reserve profile.

Upside scenario

Although unexpected during our outlook horizon, we could raise the rating if growth in Washington's debt levels were to moderate, alongside sustainable growth in revenue that keeps pace with both the state's underlying economic growth rates and mandated costs originating from voter-approved initiatives that, to a degree, limit the state's budgetary flexibility.

Credit Opinion

Washington revenues running ahead of estimates as recovery continues

Through Sept. 24, 2021, Washington's general fund revenue collections are somewhat stronger than expected by $842.6 million (1.5%) above the prior forecast conducted in June 2021. Most of this increase stems from better-than-anticipated performance in retail sales collections ($399.2 million or a 1.5% increase) and real estate excise taxes ($293.6 million or a 12.5% increase). Forecasters note real estate excise tax collections have been strong following a large increase in commercial sales on top of continued strength in residential sales.

Changes to the baseline forecast since the last review included updated state personal income results from the U.S. Bureau of Economic Analysis. The baseline projections reflect The Boeing Co.'s announcement of a significant reduction to employment across the company as well as the movement of some aircraft production from Washington to South Carolina. The forecast assumes Boeing is about three-quarters of the way through this process, and that most employment cuts going forward will be made in Washington and that non-Boeing aerospace employment will also decline as a result of lower production rates. Specifically, Washington assumes aerospace employment will be 29,200 lower in January 2022 than in January 2020, consistent with the council's prior June 2021 forecast. Although we view Washington's economy as sensitive to swings in the state's aerospace industry, we believe the state's economy is well-diversified.

The council's optimistic scenario assumes a quicker recovery including more robust response to fiscal stimulus packages, accelerated vaccinations, greater adherence to social distancing guidelines, and faster recovery in aerospace employment. Conversely, the council's pessimistic scenario assumes a weaker recovery in consumer spending, a resurgent virus, and failure to recover aerospace employment.

Washington's capital gains tax will become effective in January, but legal challenges persist

On May 4, 2021, Washington's governor enacted legislation that imposes an excise tax on the sale or exchange of long-term capital assets. The capital gains tax, which is effective Jan. 1, 2022, is only subject to individuals with capital gains of more than $250,000 annually and is calculated as 7.0% multiplied by the state's calculation of adjusted capital gains. In our opinion, the tax introduces some additional cyclicality to Washington's revenue mix, given the state's dependence on its top taxpayers, as well as investment performance.

The enacted legislation directs revenues for children's education purposes to the education legacy trust account; the state considers the account to be near general fund, although it is separate from the general fund itself. The first payments are due to the state in April 2023 within the final quarter of the state's current biennium. Forecasters anticipate the tax will have a positive net revenue impact of $415 million in the fiscal 2021-2023 biennium for near general funds, which we consider to be relatively minor at 0.7% of projected near general fund revenues. In the following fiscal 2023-2025 biennium, the net revenue impact more than doubles to $840 million, or 1.4% of projected near general fund revenues, since the tax is presumed to be effective for the entirety of the biennium. We note that in recent years, the state has dealt with education funding challenges while at the same time pursuing efforts to diversify its tax base.

The state is currently party to two lawsuits seeking to void the capital gains tax, based on claims it is an unconstitutional income tax. We understand the litigation could potentially halt collection of the tax at some point in the future. If this scenario were to occur, we believe it could challenge both Washington's structural balance, given the inclusion of capital gains revenue in current forecasting. While the state's constitution requires annual transfers into the BSA of at least 1% of general-fund state revenues, the transfer could potentially also be nominally lower given a smaller revenue base. However, we believe the forecast capital gains revenues are somewhat minimal at 0.7% and 1.4% of projected near general fund revenues in the fiscal 2021-2023 biennium and the fiscal 2023-2025 biennium, respectively. In addition, we expect the state's history of strong fiscal management will likely insulate Washington's credit profile from this budgetary pressure, based on current forecasting, should it arise.

Washington officials note the state will go through two legislative sessions before any capital gains tax revenues are collected in 2023, during which the legislature will be able to react to the outcome of any legal challenges.

American Rescue Plan Act funds mostly allocated for one-time items but some revenue replacement for transportation accounts included

The federal government allocated a substantial amount of federal money to Washington through the American Rescue Plan Act (ARPA). The state expects to receive more than $10.6 billion in ARPA funds for grants to the state government and grants directly to local governments, certain industries, and higher education institutions. Officials expect the state government's share will be between $7.8 billion and $8.6 billion, including $4.4 billion from the state fiscal recovery fund.

Washington's legislature has already appropriated $6.2 billion of the state government's share: $3.15 billion is from the state fiscal recovery fund and $3.07 billion is grants from various federal agencies to state government. While these grants might not have been awarded yet, the state budget includes the federal spending authority. Notable appropriations include those for negative economic impacts ($1.6 billion), infrastructure projects ($1.3 billion), revenue replacement for transportation accounts ($600 million), and COVID-19 pandemic-related public health needs ($143 million). In our view, Washington has prudently prioritized spending most of its share of ARPA funding for one-time items. The $600 million allocated for transportation accounts, however, is replacing recurring revenues due to declines in travel during the pandemic. While we believe this figure is sizable when compared with total projected transportation revenues for the current fiscal 2021-2023 biennium (at 9.0% of biennial revenues), it is relatively minimal compared with the state's larger general fund budget (at 1.1% of biennial revenues). In addition, the transportation revenue forecast council's latest forecast as of September 2021 expects growth to continue; its 10-year forecast is up by $179 million, or 0.5%, from its previous June forecast.

The state has not yet appropriated the remaining $1.3 billion of funds available from the state fiscal recovery fund, providing Washington additional budgetary flexibility, in our view. In December, the governor will provide a spending proposal to the state legislature for this amount. The plan is expected to consider additional recovery needs and the impacts of the delta variant, which could affect recent public health and economic gains.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of October 20, 2021)		
State of Washington var purp GO rfdg bnds ser R-2021C due 08/01/2036		
Long Term Rating	AA+/Stable	Affirmed
State of Washington MVFT/VRF GO bnds ser 2021F due 06/01/2046		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of October 20, 2021) (cont.)		
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 20, 2021) (cont.)		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 20, 2021) (cont.)		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (MBIA)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (SYNCORA GTY)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
FYI Properties, Washington		
State of Washington, Washington		
FYI Properties (Washington) APPROP		
Long Term Rating	AA/Stable	Affirmed
State of Washington, Washington		
State of Washington, Washington		
Washington St Toll Facilities, Washington		
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.